



Success of a SOO: The VBA Story

By Catherine Poole

Our May 2001 *Advisory*¹ presented our recommended approach for conducting true performance-based contracting. The approach: Identifying the government's objectives in a Statement of Objectives (SOO), identifying legitimate constraints, and allowing industry (read: the experts) to propose solutions to meet the objectives. This approach aligns both parties—government and contractor—toward meeting the same objectives.

Our clients have tried this approach in a number of cases and it works no matter what type of service is being acquired. This *Advisory* presents a case study on the use of the SOO approach at the Veterans Benefits Administration (VBA) for its portfolio loan servicing contract. VBA wanted a contract that would take advantage of acquisition reform initiatives — a performance-based contract with a positive incentive structure for the contractor. With Acquisition Solutions and PriceWaterhouseCoopers (PwC) by its side, VBA used the SOO approach, identifying its objectives for the program and allowing industry to propose the solutions. The result was a contract awarded quickly and efficiently to the offeror proposing the best solution toward meeting the objectives—and a program that is meeting those objectives. Here's the story.

Background

VBA's Loan Guarantee Program provides home loan benefits to eligible veterans obtaining mortgage loans through private lenders by guaranteeing a portion of the loan against default. If a veteran's home loan is foreclosed by the mortgage company, VBA often purchases the property from the lender, taking ownership. It then advertises and sells the property to the public, frequently providing seller financing. VBA's Loan Guaranty Service (LGS) is responsible for ensuring the proper servicing of these loans and other special program loans. Servicing includes a variety of activities, including collection and application of payments, ensuring that all property taxes and insurance payments are made on time, and providing customer service functions.

Approximately 29,000 loans were serviced directly by the Loan Guaranty Service's regional offices until 1997 when VBA recognized the need to outsource the services, in part due to the increasing inability of its IT systems to accommodate changes in legislation and reporting requirements. When contracting out loan servicing for the first time in 1997, VBA issued a Request for Proposals (RFP) with a Statement of Work detailing the tasks of the

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contractor. Selection of a contractor was based primarily on evaluation of a written proposal, which responded line by line to VBA's detailed specifications. Little, if any, industry research was conducted. The resulting contract included neither incentives for superior performance nor disincentives for less than acceptable performance. The result was, in effect, a transaction-based contract: The contract (inadvertently) incentivized transactions, but not results.

By 2000, VBA changed its philosophy about its portfolio loans. Based on these changes and other factors, VBA decided that, even with two option years on its existing contract, the time was right for rewriting the servicing contract to incorporate VBA performance goals, instead of simply stating how the minimum requirements were to be accomplished. VBA sought to take advantage of acquisition reform initiatives and the trend toward performance-based contracting, as well as GSA's new Federal Supply Schedule contracts with vendors qualified to service loans for the government.

The VBA Acquisition Approach

A true performance-based approach first requires an introspective look at the organization to identify mission requirements, desired outcomes and constraints to performance. It then requires research into industry practices and trends. From the knowledge gained in these two steps, the team can consolidate its requirements into a Statement of Objectives (SOO) and corresponding solicitation documents, identifying relevant background information and project constraints.

VBA's acquisition approach included several steps to help assure an effective, successful acquisition strategy. The steps:

- Facilitated In-House Interviews
- Market Research
- Development of Statement of Objectives and Solicitation
- Proposal Evaluation
- Contract Award

An in-depth discussion of these steps in VBA's acquisition follows.

In-House Interviews—Defining Success

In-house interviews were conducted with approximately 25 VBA subject matter experts (SMEs) to identify VBA's desired outcomes, current successful VBA business practices, and areas that could be improved. SMEs were asked to identify what has worked in the past, what has not, and what should be used as VBA's definition of "successful contractor performance."

The question asked of the SMEs: "What is your definition of success?"

In identifying requirements, participants were asked to keep the desired *outcome* as the primary focus, without specifying *how* VBA wanted the vendor to perform. VBA identified its biggest challenge as overcoming the mindset that the government needs to tell the contractor how to perform. The natural inclination for many was to start with the previous contract that wasn't working, "tighten the specs" and reissue the requirement tighter than ever before. They wisely resisted this temptation.

The participation by SMEs from across the various VBA disciplines—loan servicing, finance, contracting, etc.— was excellent. As a result, the facilitated meetings produced a comprehensive view of VBA's performance objectives, requirements, and issues in the areas of operations, administration, support, and customer service.

While going through the process of identifying requirements and issues, the break-out groups identified a series of issues, policies, constraints, and potential internal issues that would need to be resolved for VBA to successfully implement a new contract. These were captured as "Parking Lot" issues. They were categorized as transition, evaluation, "warts" (internal VBA issues), and to-be (versus as-is) process issues. These issues reflected areas that needed to be considered as VBA moved closer to finalizing its objectives.

For example, there were a series of issues revolving around "how well the vendor understood VBA's business processes" and the need to specify those processes as requirements so they didn't have to teach a vendor how VBA worked. It was determined that, rather than identifying a multitude of potentially constraining requirements that may not allow VBA to take advantage of better, commercially available practices, this would be evaluated as part of the selection process. One of the evaluation criteria would be the offeror's understanding of VBA's business processes and how they intended to meet those needs.

The results of this effort, along with those of the market research would be used to develop the VBA's Statement of Objectives and source selection criteria.

Market Research

We addressed the importance of market research in our February 2001 *Advisory*,² stressing that market research *done right* can fundamentally change the nature of both *what* the agency will buy and *how* the agency will buy it. The outcome of good market research is the development of a true performance-based acquisition strategy that sets a scenario for success for agency programs and program managers.

VBA conducted market research through a series of one-on-one meetings with selected industry leaders. VBA used the research capability of PwC and its access to industry ratings of companies to choose the participants based on their overall corporate experience and success in the loan-servicing field. PwC reviewed current ratings by commercial rating services to identify companies rated by the services as leaders in the industry *and* that were on the GSA Federal Supply Schedule.

As part of this effort, a letter to the selected industry participants was developed that outlined the background on VBA's program and portfolio and included an agenda to help ensure these meetings would be productive for both the government and industry. Each company was asked to discuss its corporate capabilities and then, for both the industry and their company, identify best practices, performance indicators, measures, and incentives.

You may ask, "Are contractors really willing to share that information?" Our experience says "Absolutely!" In this case, all invited companies attended

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their “one on one” meeting and were more than willing to share information. In fact, it was during these one-on-one sessions that VBA learned of the inherent flaws in its transaction-based pricing methodology, and became aware of a standard industry practice in which the loan servicer only gets paid when the loans perform. As a result of the market research, VBA changed its pricing methodology and further encouraged offerors to propose alternative incentive-based pricing methodologies.

These industry exchanges were “invaluable,” in the words of VBA’s Task Order Project Manager (TOPM)—“A real eye-opener.”

Developing the Statement of Objectives

Armed with information from the internal assessments and industry exchanges, the team set out to “pen and ink” VBA’s objectives. While at times it proved challenging to stick to objectives as opposed to procedural requirements, the overarching objectives prevailed. Here is what they came up with—verbatim—as provided in the solicitation:

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“VBA expects to improve its current loan servicing operations through this task order in several ways. Primary among these is to increase the number and value of saleable loans. In addition, VBA wants to be assured that all payments for such items as taxes and insurance are always paid on time. As part of these activities, VBA also has an objective to improve Information Technology data exchange, improving VBA’s access to information on an as needed basis and improving VBA’s ability to meet customer needs and to respond to auditors’ requirements.

Complementing the effort to accomplish these three objectives, two other equally important goals of VBA are: (1) to increase the fiduciary controls and reports in such areas as daily reconciliations, application of cash, and Treasury guideline requirements; and (2) to improve default management activity in such areas as pursuing and documenting all loss mitigation tasks and related borrower communication efforts up to termination of a loan. This includes taking special forbearance actions where appropriate for disabled veterans.

Consistent with the improved activity and interface with borrowers for default management, VBA has an objective to improve overall customer service by increasing responsiveness and customer contact, and minimizing customer complaints.

As building blocks for these objectives, VBA’s objectives also include increasing the efficiency of all portfolio activities, the accuracy of loan servicing information, and the timeliness and flexibility of recurring and ad hoc reporting. In addition, a basic building block objective is to substantially improve loan file information, including accuracy, completeness, and currency.

Finally, VBA has an objective to have active, verifiable quality control and audit procedures that will provide an accurate assessment of performance objectives, their measures, and how well they are indicating the quality of service being provided and being used to actually improve service to VBA.”

That's it—you might wonder? *That is it*—The short and sweet, to-the-point objectives of the program. But those five paragraphs speak volumes—and leave the solution, the “how to get there,” to the offerors, who are the true experts in the field. It represents true performance-based acquisition. Of course, the solicitation contained additional information, such as background and restrictions, but the concisely written statement of objectives conveyed the desired outcomes and provided the basis for the alignment of the government's and contractor's goals and ultimate success of the acquisition and program.

Solicitation of Proposals

A Request for a Task Order Proposal (RTOP) was released to the four identified Federal Supply Schedule (FSS) vendors, who were given about three weeks to prepare their proposals. The RTOP included VBA's Statement of Objectives, background on VBA's loan portfolio and processes, as well as a CD-ROM with a “Salomon 400” dump of the current VBA portfolio (this was revealed during market research as a critical piece of information to the loan servicing vendors in preparing their proposals.)

During the proposal preparation period, VBA also provided offerors the opportunity to visit VBA's library and perform due diligence³ in learning about and developing an understanding of VBA's portfolio. This is a common approach within industry when servicers are evaluating what is necessary to take over a portfolio from another company (also revealed during the market research.) This step allowed the offerors to evaluate what existed and what didn't, and provided them with the information they needed to understand the potential impact on the prices they would propose.

Each vendor was asked to provide the following as part of its task order proposal:

- A detailed Statement of Work – to demonstrate how the vendor would meet VBA's objectives.
- Relevant performance indicators – that VBA could use to measure how well the contractor performs on an ongoing, regular basis.
- Quality and audit processes currently in place.
- Incentives the government could use to continually encourage them to improve performance over the life of the contract.
- Past performance information, including industry ratings, certifications or awards.
- Price proposal, inclusive of any incentives on which the contractor would like to be measured and rewarded.

Steve Kelman, Harvard professor and former Administrator of the Office of Federal Procurement Policy (OFPP), said recently that making companies set their own performance measures is “state of the art” contracting.⁴ Few government agencies are using such a strategy today.

Evaluation of Proposals

Among other things discussed during the SME in-house interviews were appropriate criteria against which proposals should be evaluated. As mentioned previously, an understanding of VBA's portfolio and objectives was key, and therefore became one of the primary evaluation criteria. The

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resulting criteria align with the submission requirements discussed above, as follows:

1. Technical & Management Approach
 - a. Knowledge and understanding of VBA's mortgage loan portfolio, including the capability to meet VBA's objectives
 - b. Knowledge, understanding, and capability to transition VBA's mortgage loan portfolio
 - c. Quality control plan and audit programs
 - d. Performance incentive plan
 - e. Policies to ensure VBA's investments and assets are protected
2. Past Performance
 - a. Industry ratings and certifications
 - b. Other information available to the government
 - c. Customer references
3. Price

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An interesting aspect of SOO-based acquisition is the range of solutions that may be proposed. We've often been asked how evaluations should be conducted when the solutions can vary so significantly that the team is, in effect, comparing 'apples' to 'oranges.' The key evaluation criterion, in our opinion, is an understanding of the requirement, as evidenced by the proposed means of meeting the objectives. As we've often stated, it is much easier to recognize a good idea than it is to invent one!

With regard to the evaluation of past performance, we encourage agencies in drafting evaluation criteria not to limit the evaluation to references (which are often biased), but to include independent ratings, certifications—like ISO 9000—or other awards or peer recognition. Recognition of the vendor by independent organizations offers a much more realistic picture of the quality of the organization than do individual references.

After the initial review of the proposals, VBA invited each offeror to make an oral presentation to clarify its proposal and emphasize certain capabilities the government had identified as important to successful loan servicing. At the end of these presentations, the Technical Evaluation Panel (TEP) took a short break to decide on any clarification questions that needed to be asked of the presenter. Immediately following the conclusion of each oral presentation, the TEP met to complete their evaluations.

Contract Award

The contract was ultimately awarded to Countrywide Home Loan Mortgage Company under its Federal Supply Schedule in less than eight months from the date the decision was made to re-compete the contract. This includes the time spent meeting with in-house personnel to define objectives and constraints, participate in market research exchanges with industry, perform the due diligence process, and solicit and evaluate proposals. Contrast that with the two years it took to fine-tune the requirements for the original contract and you can begin to see the value of this process!

Countrywide proposed—and VBA accepted—what could be called the “ultimate” performance incentive: the contractor is paid only when the loan

performs. For non-performing loans, there is no payment until the loan is successfully foreclosed. Countrywide did an excellent job of establishing its credentials as “expert in the field” —as evidenced by pre-existing processes and quality control procedures—and communicating its understanding of VBA’s objectives. Importantly, Countrywide’s proposed incentives reflect the understanding of the importance of meeting those objectives.

Objectives Achieved!

VBA is absolutely thrilled with the resulting contract and the contractor. In a one-year period, the contractor has completely absorbed VBA’s portfolio and has improved the portfolio’s performance “phenomenally.” The contractor is currently on track to meet or exceed all of the objectives. Achievement of the objectives was estimated to increase Treasury receipts from increased collections of VBA loan repayments by millions of dollars each year. The default rate on loans is already decreasing significantly.

An added ‘bonus’ made possible through the use of the SOO approach is the fact that the contractor has actually taken on additional tasks beyond those in its proposal to *ensure* that it meets the objectives. An example: Some of the data provided by VBA has not proven to be reliable due to coding errors. The new contractor has taken on the task of researching and verifying the data to ensure reliability so that its processes can run smoothly in order to ensure objectives are met. Since the contract requires the contractor to meet the objectives—as opposed to performing specific tasks—the costs of this performance are borne by the contractor and are not priced out on a per-task basis to the government. The contractor is motivated to perform the job right in order to meet the objectives.

Lessons Learned

Certainly, any time you try something new, there are lessons learned. Following is a brief summary of the lessons learned in the VBA project:

- The exchanges with industry were invaluable. If the project were repeated, the agency may have invited a few more participants from industry.
- Don’t skimp on the due diligence process. The more the prospective offerors learn about and understand the organization and the problems, the better the proposed solutions will be.
- Resist the temptation—however strong—to dictate the process the contractor must follow.
- Involve all stakeholders early in the process—consider stakeholders beyond the procurement and program office, including finance and audit representatives, as applicable, and customers.

Conclusion

The acquisition environment has changed significantly over the past several years. Acquisition reform has focused the government’s agencies and managers on results. Improved access to, and use of, market research empowers the government to better align the acquisition process with the

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program objectives and commercial marketplace realities. Contracting and source selection processes have been changed to make the process more effective and efficient. The tools, techniques, and contracting concepts that now can be applied to the acquisition process can, if wisely applied, produce extraordinary results.

VBA's portfolio loan servicing re-competition is proof of the power of sound acquisition planning, processes and implementation and the value of expressing requirements in terms of outcomes.

Would VBA use this approach again? "Absolutely."

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Acquisition Solutions has used the Statement of Objectives approach in a variety of situations—including information technology outsourcing—with positive results. This Advisory presents one of many performance-based acquisition success stories across the government.

For more information about performance-based contracting, including the SOO approach, we refer you to the web-based knowledge center, "7 Steps to Performance-Based Services Acquisition." We are proud to have been a part of the interagency team that developed the virtual guide. See <http://oamweb.osec.doc.gov/pbsc/index.html> or link from the Acquisition Solutions homepage (<http://www.acquisitionsolutions.com>).

Endnotes

¹ Acquisition Directions™ May 2001 *Advisory* is entitled, "An Innovative Approach to Performance-Based Acquisition: Using a SOO." (See page 1)

² Acquisition Directions™ February 2001 *Advisory* is entitled "A Program Manager's Guide to Realizing Marketplace Potential." (See page 3)

³ "Due diligence" is used in acquisitions to describe the period and process during which competitors take the time and make the effort to become knowledgeable about an agency's needs in order to propose a competitive solution. (See page 5)

⁴ "Airport security agency seeks bids for explosive detection machines," GovExec.com, February 12, 2002, viewable at <http://www.govexec.com/dailyfed/0202/021202h1.htm> (See page 5)